No. 20,548

IN THE

United States Court of Appeals

For the Ninth Circuit

JAMES H. GONDER and
MARY D. GONDER,
Appellants,

vs.

HOYT F. KELLEY,
Appellee.

APPELLANTS' BRIEF

COTTRELL, HOFVENDAHL & ROESSLER,
210 North Fourth Street,
San Jose, California 95112,
Attorneys for Appellants.

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I. STATEMENT OF PLEADINGS AND JURISDICTIONAL FACTS

This is an appeal from an order made September 21, 1965, by the United States District Court for the Northern District of California, Southern Division, determining the dischargeability of a debt owing from the bankrupt appellee, to appellant.

Appellant commenced this proceeding on October 28, 1964, by the filing of an Application to Determine Dischargeability of a Debt in the office of the Referee In Bankruptcy, Daniel R. Cowans. After hearing, the Referee determined that the debt was non-dischargeable. The bankrupt and appellee herein then petitioned the District Court for a review of the Referee's order under Section 39(c) of the Bankruptcy Act (11

U.S.C. 67(c)). After review, the District Court reversed the Referee's order; appellant's appeal from the order of the District Court under Section 24 of the Bankruptcy Act (11 U.S.C. 47).

II. STATEMENT OF THE CASE

This proceeding in bankruptcy was commenced to determine the dischargeability under Section 17(a)(2) of the Bankruptcy Act of a debt due to them from the bankrupt. The application to determine dischargeability alleged, among other acts of misconduct, that the bankrupt had comingled trust funds and converted the same to his own personal use (1 Transcript of Record 2, lines 25 through 29; hereinafter cited as TR). After a hearing on the application, the Referee held the debt to be non-dischargeable (1 TR 8-9), and found as a fact that the bankrupt had comingled trust funds with his own personal funds and converted the same to his own use and benefit (1 TR 11, lines 25-28; 1 TR 12, lines 7-10). The Referee also found as a fact:

> "9. That thereafter, and on or about the 10th day of January, 1963, as a means of compromising the differences above referred to, applicants and bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., entered into an executory agreement of accord whereby bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., promised and agreed to pay the sum of $18,444.13 at the rate of $500.00 per month commencing March 1, 1963, in accordance with the

provisions of a written promissory note executed on or about the same date."

The bankrupt then sought a review of the Referee's order, alleging that the promissory note was accepted by appellants as a full compromise and release of all prior claims (1 TR 16, lines 8-25). After review, the District Court, in an opinion filed by The Honorable W. T. Sweigert on September 21, 1965, reversed the Referee's decision and held the debt to be dischargeable on the ground that the agreement of January 10, 1963, was a waiver and discharge of the antecedent tort liability (1 TR 41-47). This appeal follows.

III. SPECIFICATION OF ERRORS RELIED UPON

1. The District Court erred in holding that the Referee In Bankruptcy was limited to the record in the Superior Court action in determining dischargeability.

2. The District Court erred in reversing the Referee's holding that the debt was non-dischargeable.

IV. QUESTIONS PRESENTED

1. Whether the District Court should accept finding of fact made by the Referee when the finding is based not just on the terms and provisions of a written contract, but also on the total evidentiary circumstances adduced before the Referee?

2. Whether entry into an accord—executory or executed—ought to free a debtor from the consequen-

ces of his dishonest conduct and discharge that obligation in bankruptcy.

V. ARGUMENT

A. THE DISTRICT COURT SHOULD ACCEPT FINDING OF FACT MADE BY THE REFEREE WHEN THE FINDING IS BASED NOT JUST ON THE TERMS AND PROVISIONS OF A WRITTEN CONTRACT, BUT IS ALSO BASED ON THE TOTAL EVIDENTIARY CIRCUMSTANCES ADDUCED BEFORE HIM.

The opinion of the District Court was based on the conclusion that the agreement of January 10, 1963, was meant to discharge the antecedent tort obligation and not merely to suspend the debt, because the bankrupt and his wife gave a valuable consideration. In reaching this conclusion, the District Court committed one of two errors: First, it overlooked or did not consider the Referee's finding of fact that the agreement of January 10th was an executory agreement of accord. That finding was set out verbatim at page 2, supra. Second, if the finding was considered and rejected, then such rejection was itself an error because the Referee's finding was not "clearly erroneous" within the meaning of General Order No. 47 of the General Orders in Bankruptcy. For the Referee had the benefit of actually seeing witnesses and hearing the testimony in arriving at his conclusion that the agreement of January 10, 1963, was executory.

General Order in Bankruptcy No. 47 provides:

> "Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and conclusions

of law, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions."

This standard is to be applied to the Referee's findings.

Hoppe v. Rittenhouse (9 Cir. 1960), 279 F.2d 3, 7;

O'Rieley v. Endicott-Johnson Corp. (8 Cir., 1961), 297 F.2d 1, 4.

The duty of the District Court to accept the findings of fact of the Referee is mandatory, unless those findings are clearly erroneous. The United States Supreme Court has defined the "clearly erroneous" standard as follows:

"A finding is 'clearly erroneous', when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

United States v. United States Gypsum Co. (1948), 333 U.S. 364, 68 S. Ct. 525, 542, 92 L.Ed. 746, 766.

In their application to determine dischargeability, appellants in paragraph XVIII alleged:

"That thereafter and on or about the 10th day of January, 1963, as a means of compromising their differences above referred to, applicants and bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., entered into an execu-

> tory agreement of accord whereby bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., promised and agreed to pay the sum of $18,444.13 at the rate of $500.00 per month commencing March 1, 1963, in accordance with the provisions of a written promissory note executed on or about the same date." (TR 6)

At the hearing on this matter, the allegation was never disputed, the *fact* that the agreement was executory rather than executed was never questioned at all. About the only direct reference to the agreement itself during the entire hearing occurred during an argument concerning the relevance of appellee's bank records. At page 53, lines 9 through 16, the allegations were read into the record, and at page 55, lines 16 and 17, reference to the actual agreement of January 10, 1963, was made. In the face of the allegations and the argument, neither the bankrupt nor his counsel ever questioned the executory nature of the agreement. The entire thrust of bankrupt's argument was concerned with limiting the evidence to the Superior Court record. The bankrupt did not ever argue that the signing of the agreement operated in and of itself as a fully executed accord and satisfaction. At no place in the record of the hearing before the Referee is such a contention even hinted at.

Viewed realistically and against the background of these parties' circumstances, it was clear to the Referee that Dr. Gonder was not interested in any promise of any nature made by Hoyt Kelley at any time. The doctor was solely interested in getting his

money back. That is to say, he was interested solely in Mr. Kelley's performance of the promise to pay.

Thus, from the entire evidence adduced before him, the Referee concluded as a fact that the agreement was executory and embodied that conclusion in his finding of fact No. 9. Such a finding, of course, permits appellant herein to enforce the original tort obligation; for when a debtor breaks an executory agreement of accord the creditor has alternative rights. He can enforce either the original duty or the subsequent contract, 2 Restatement of the Law of Contracts, Sec. 417(c); 6 Corbin on Contracts, 76 ("There is unlimited authority to the effect that an accord executory, providing for a future discharge of a claim, is not itself a present discharge.")

In doubtful cases, the Restatement of Contract provides a canon of interpretation or construction in Section 419:

> "Where a contract is made for the satisfaction of a pre-existing contractual duty, or duty to make compensation, the interpretation is assumed in case of doubt, if the pre-existing duty is an undisputed duty either to make compensation or to pay a liquidated sum of money, that only performance of the subsequent contract shall discharge the pre-existing duty; but if the pre-existing duty is of another kind, that the subsequent contract shall immediately discharge the pre-existing duty, and be substituted for it."

While the District Court takes the position in its Opinion at page 6 (1 TR 46) that the bankrupt and his wife gave valuable consideration in that they made

themselves personally liable for what was a former debt of the corporation, that is too facile a resolution of the problem. In point of fact, there never was a dispute about the bankrupt's obligation to repay this debt. The only question was how much the payments would be and when they would be made. On this question, Professor Corbin states that "If an agreement is a compromise of a disputed claim, it is perhaps *more likely* to be declared by the court to be a substituted contract." 6 Corbin on Contracts, 72 n 4. However, he also states:

> "The term 'accord executory' is and always has been used to mean an agreement for the future discharge of an existing claim by a substituted performance. In order for an agreement to fall within this definition, *it is the promised performance that is to discharge the existing claim,* and not the promise to render such performance. Conversely, all agreements for a future discharge by a substituted performance are accords executory. *It makes no difference whether or not the existing claim is liquidated or unliquidated, undisputed or disputed,* except as these facts bear upon the sufficiency of the consideration for some promise in the new agreement . . ." (Emphasis added.)

These comments were cited with approval in *Heagney v. Brooklyn E. Dist. Terminal,* 190 F.2d 976, 979 (C.A.2d, 1951), where the court states:

> "Quite in point, therefore is Professor Corbin's enlightening discussion of compromise agreements and their connection with executory accords. Thus, he says: 'By thinking and speaking in

> terms of compromise the existing befuddlement in regard to executory accords is avoided.' . . . Hence as he points out, there may be a compromise furnishing an agreed upon substitute for performance which, in turn, may require specific performance, although generally it may be reasonably clear that the parties intend a discharge 'only when the compromise performance is rendered.' " 6 Corbin on Contracts, 71-72, n 4.

The point here is that the Referee had before him th "entire evidence", and decided that Doctor Gonder was interested in Mr. Kelley's performance, not his promise. That is to say, that the Referee decided that the accord agreement was executory rather than executed or a substituted contract. On the evidence, and in light of the above canons of construction the Referee's finding on that issue of fact should be binding on the District Court. The District Court, therefore, erred in substituting its own findings on that issue of fact, and accordingly, the order of the District Court should be reversed.

B. ENTRY INTO AN ACCORD—EXECUTORY OR EXECUTED—OUGHT NOT TO FREE A DEBTOR FROM THE CONSEQUENCES OF HIS DISHONEST CONDUCT BY DISCHARGING THAT ACCORD IN BANKRUPTCY.

In its opinion, the District Court adopted the rule enunciated by the Seventh Circuit in *Maryland Casualty v. Cushing,* 171 F.2d 257 (7th Cir., 1948) (1 TR 46, lines 23-25). The District Court then held that it was error for the Referee to go behind the accord

agreement of January 10, 1963, and the note given pursuant thereto. In the *Cushing* case, supra, the accord agreement was oral but was found as a matter of fact by the trial judge that at the time the parties entered into the accord agreement and delivered a promissory note in consideration thereof, that the creditor promised and agreed to waive the tort action. Thus, the case held as a matter of law that the tort liability had been satisfied and discharged by the execution of the note and that the indebtedness upon the note in turn was barred by the discharge in bankruptcy. 171 F.2d 257, 259.

In this argument appellant proposes to meet the rule of the *Cushing* case head-on and to petition this Court to adopt a different rule. The *Cushing* case turns on a technical question of the law of contracts —whether an accord agreement is executory or executed. In the case before this Court, we have two lower courts disagreeing about that technical question. While appellants contend that an executory agreement was intended, in this argument appellant also takes the position that the question of dischargeability ought not to turn on technical points in the law of contracts, but that the question of dischargeability should be determined in light of the policy underlying Section 17 of the Bankruptcy Act.

The second clause of Section 17 of the Bankruptcy Act provides as follows:

> "a discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . .

> (2) or liabilities or obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining the extension or renewal of credit in reliance upon a materially false statement respecting his financial condition made or published in any manner whatever with intent to deceive, or for wilful and malicious injuries to the person or property of another . . ."

In his recent work on Bankruptcy Law and Practice, the Referee who heard this case below has set out the policy reasons for Section 17:

> "The policy of relief to beleaguered debtors is a highly important one in bankruptcy. It is considered of a high order of importance to give unfortunate debtors a fresh start and return them to useful production. This policy is not so important, however, as to negative other important policies which the law feels a responsibility to foster and abet. In general, the two bases of policy upon which the exceptions of Section 17 of the Act appear to be founded are . . . (2) that the relief of discharge is intended for the honest and thus certain debts created by the debtor's unlawful or oppressive conduct should remain his obligations." Cowans, Bankruptcy Law and Practice, p. 212.

That policy is well known to this Court. In *Bruning v. United States,* 317 F.2d 229, 231 (9th Cir., 1963), affirmed, 376 U.S. 358, 84 S.Ct. 906, 11 L.Ed.2d 772, Circuit Judge Chambers, speaking for the court, said:

> "Section 17, (a) is not a compassionate section for debtors. Congress, speaking for society, has

> decided that the problems of others: the government, the abandoned-dependent wife, the defrauded widow, override the value of giving the debtor a wholly new start in life." *Ibid.*, p. 231.

In light of this policy, appellant most earnestly contends that dischargeability should be determined from the original character of the act on which the liability is based, regardless of the intervening steps the creditor may take to reduce his claim to money. There is persuasive support for this point of view in the cases. In *Guernsey-Newton Co. v. Napier,* 275 Pac. 724 (Wash., 1929), the Supreme Court of Washington said:

> ". . . The fact that the appellant wrote the respondent a letter and enclosed a note for him to sign covering the obligation has no material bearing upon the question, *and would not have had even though the note had been signed and reduced to judgment.* In a bankruptcy proceeding it is the original character of the liability which determines whether it is dischargeable. In order to determine the original character of the liability the courts will look behind the judgment if the obligation has been reduced to judgment.
>
> "In *Donald v. Carroll,* 111 Ind. 1, 11 N.E. 782, it is said: 'Where the enforcement of a judgment is sought to be defeated by a discharge in bankruptcy, it is proper to look behind it to the character of the debt upon which it is founded; and if it is ascertained that it belongs to a class upon which the discharge does not operate, the judgment will be enforced.' " (Emphasis added.)

The *Napier* case was recently cited with approval in *Taitch v. Lavoy,* 360 P.2d 588 (Wash., 1961).

In *Zimmern v. Blount,* 238 Fed. 740 (5th Cir., 1917), the Circuit Court of Appeals for the Fifth Circuit stated that

> "the plaintiff has the right to proceed upon a note and at the same time seek to enforce his alleged cause of action for deceit. They are in no sense inconsistent remedies . . ." (p. 745)

There is, of course, the contrary view of the *Cushing* case, *supra,* in the 7th Circuit, and there is language stating the contrary view in the leading state court case on the point, *Fidelity & Casualty Co. of New York v. Golombosky,* 133 Conn. 317; 50 A.2d 817, 820, 170 A.L.R. 361, 365 (1946). An annotation on the point is set out at 170 A.L.R. 368; *"Character of original claim as non-dischargeable as preventing discharge in bankruptcy of judgment on note given therefor,"* and the editors of that annotation state:

> "Thus, it has been generally held that a claim which is not dischargeable under the provision of the Bankruptcy Act is not rendered dischargeable by the recovery of a judgment thereon. In such case the judgment itself is not dischargeable." *ibid,* p. 368.

The editors of American Jurisprudence 2d have also taken the position that this is a better rule:

> "Persuasive reasons support this view. A creditor should not be placed in the dilemma of foregoing his right to assert an exception to discharge either by the act of accepting a note from the debtor or by securing the rendition of a judgment

> on the note. He is in no sense attacking the judgment by introducing extrinsic evidence of the non-dischargeable character of the original obligation. The rendition of a judgment does not involve the issue of whether the debt is one dischargeable in bankruptcy." 9 Am.Jur.2d 616.

Indeed, in all of the cases which permit the creditor to prove the dishonest character of the original debt by evidence extraneous to the record of any judgment, the courts in effect are holding that a mere change of form involved in reduction of the claim to a judgment should not be permitted to thwart the application of the policy underlying Section 17 of the Bankruptcy Act. *Tucker v. Colwell,* 193 U.S. 480 (1903); *Boynton v. Ball,* 121 U.S. 457, 466. The question presented in the case at Bar is whether the bankrupt himself should be permitted to thwart that policy by entering into a contract of accord. Appellants contend that he should not, and that the question of dischargeability should turn on the original character of the acts giving rise to the liability, namely that of a wilful and malicious injury to the property of another. For that reason, appellants respectfully urge the reversal of the District Court's order.

Dated, San Jose, California,
February 24, 1966.

Respectfully submitted,
COTTRELL, HOFVENDAHL & ROESSLER,
By JOHN N. NORMAN,
Attorneys for Appellants.

Certification

I certify that in connection with the preparation of this Brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Dated, February 24, 1966.

John N. Norman